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Questar Pipeline Company v. Utah State Tax Commission : Reply Brief

Utah Supreme Court

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-100592-CA

IN THE SUPREME COURT OF THE STATE OF UTAH

QUESTAR PIPELINE COMPANY,	)	
	)	
Petitioner,	)	
	)	Case No. 900592
v.	)	
	)	(Priority Category 15)
UTAH STATE TAX COMMISSION,	)	
	)	
Respondent.	)	

REPLY BRIEF OF PETITIONER
QUESTAR PIPELINE COMPANY

ON PETITION FOR REVIEW FROM THE
UTAH STATE TAX COMMISSION

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REPLY BRIEF OF PETITIONER
QUESTAR PIPELINE COMPANY

Questar Pipeline Company (Questar) respectfully submits its reply brief in response to the brief of respondent Utah State Tax Commission (the Commission), filed June 20, 1991.

INTRODUCTION

The thrust of Questar's request for review of the action of the Tax Commission is that it seeks a fair and lawful evaluation of the fair market value (FMV) of its property, as required by Utah Code Ann. § 59-2-102(6) (1987). As set forth in its Opening Brief (the "Questar O.B."), Questar believes the Commission has reached a company-wide evaluation of $296 million by means that do not comport with the Utah Administrative Procedures Act and applicable case law.

The Commission's responsive brief does not overcome the fundamental shortcomings of the Commission's original December 3, 1990, order: The order does not meet minimal standards of arriving at rational conclusions from the evidence and the applicable law, nor does it provide a perceptible line of reasoning by which the taxpayer and the reviewing court can evaluate the Commission's final $296 million evaluation.

I. The Theory Advanced in the Commission Brief Would Permit Nearly Unbridled Agency Discretion to Determine Taxpayers' Liability in the Name of "Exercising Judgment"

The real foundation of the Commission's Brief is found on pages 36-43, where it argues that the final determination of property value from the various methods under the consideration is a matter of the Commission's judgment. Questar does not contest the legal principle of according the Commission some deference to the expertise it has in specialized, technical areas. On the other hand, the position advanced in its brief would, in the name of judgment and agency expertise, give *carte blanche* to the Commission to assign nearly any number to the taxpayer's property as long as some witness alluded to a range of values containing the number. Questar does not believe the UAPA and applicable case law is so permissive.

A. Standards Under the Milne *and* Mountain States Legal Foundation *Cases.*

The Commission seems unwilling to recognize that it must treat taxpayers in a way that is accountable. This Court has pointedly addressed this principle in *Milne Truck Lines, Inc. v. PSC*, 720 P.2d 1373, 1378-79 (Utah 1986), and *Mountain States Legal Foundation v. PSC*, 636 P.2d 1047, 1058 (Utah 1981). In those cases the Court established that state agencies must provide those they regulate and the reviewing courts not only with findings of ultimate facts, but findings of all material subordinate factual issues.[1]

The Court stated in *Mountain States*, and reaffirmed in *D and H Real Estate Co. v. PSC*, 784 P.2d 158, 159 (Utah 1989):

> To enable this Court to determine whether an order is arbitrary and capricious, the Commission must make findings of fact that are sufficiently detailed to apprise the parties and the Court of the basis for the Commission's decision . . . .
>
> For this Court to sustain an order, the findings must be sufficiently detailed to demonstrate that the Commission has properly arrived at the ultimate factual findings and has properly applied the governing rules of law to those findings.

The *Milne* case elaborates on the obligations of an agency to provide reasoned decision-making:

> The Commission cannot discharge its statutory responsibilities without making findings of fact on all necessary ultimate issues under the governing statutory standards. *It is also essential that the Commission make subsidiary findings in sufficient detail* that the critical subordinate factual issues are highlighted and resolved in such a fashion as to demonstrate that there is a logical and legal basis

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[1]Although these are pre-UAPA cases, the principles of agency accountability that are discussed are at least as strongly applicable under the UAPA as under former agency-review standards. *See Vali Convalescent and Care Institutions v. Division of Health Care Financing*, 797 P.2d 438, 443 n.6 (Utah App. 1990).

> for the ultimate conclusions. The importance of complete, accurate, and consistent findings of fact is essential to a proper determination by an administrative agency. To that end, findings should be sufficiently detailed to disclose the steps by which the ultimate factual conclusions, or conclusions of mixed fact and law, are reached . . . . Without such findings, this Court cannot perform its duty of reviewing the Commission's order in accordance with established legal principles and of protecting the parties and the public from arbitrary and capricious administrative action.

720 P.2d at 1378 (emphasis added). In some ways, the *Milne* case is similar to the case currently before the Court. As did the Public Service Commission in *Milne*, the Tax Commission has made findings only on the barest of ultimate issues—here, the ultimate evaluation of $296 million—and has failed to provide "subsidiary findings in sufficient detail that the critical subordinate factual issues are highlighted and resolved." As Questar has argued in its opening brief and in this reply brief, the Commission's actions do not provide "complete, accurate and consistent findings of fact . . . essential to a proper determination" of FMV.

B. Commission "Judgment" Has Not Addressed Subordinate Factual Issues.

Any fair and reasonable analysis of the evidence must come to grips with the financial realities facing a rate-regulated company such as Questar. Quite simply, the Commission has not disposed of pivotal subordinate issues either in its final order or in its brief. In the context of *Milne* and *Mountain States*, the Commission never explained such fundamental matters as:

1. How is it possible for Questar's FMV to be 41% higher than the rate-

base/cost value[2] placed on the Company by the rate-regulating agency for purposes of producing a rate of return to investors that is comparable to other investments of comparable risk?[3]

Given that Questar's revenue and income stream are wholly determined by the ratemaking procedures of the Federal Energy Regulatory Commission (the "cost method"), what is it about this company that would induce a knowledgeable and willing investor/buyer to pay 41% more than the rate base on which the FERC has determined a just and reasonable rate of return may be earned? (See Questar's O.B. at 16-25.)

The Commission's Brief still has given no answer to this question, except to state and restate in conclusory fashion that the Commission believes the income method is the most reliable method, the cost method the least reliable and that the stock-and-debt (market) method "tests the reliability" of the cost method. The sum total of the Commission's reasoning on these foundational matters is found in

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[2]Stipulated rate-base/cost = \$210 million; Commission evaluation = \$296 million. (\$296 − \$210) ÷ \$210 = 41%.

[3]It is something of an irony that the Division of Public Utilities and the Tax Commission—two agencies of the same sovereign, the State of Utah—pull the corporate citizen in opposite directions when determining the value of the company. As an agency of the State to generate *revenues*, the Tax Commission has a bias toward increased valuation of facilities. As one of the watchdogs of ultimate *utility rates* in Utah, the Division of Public Utilities tends to take positions that would keep the valuation of the pipeline's assets lower—the lower the rate base, the lower the resultant rates. The rate-regulated taxpayer is caught in the middle. In a super-equitable world, one might require the State's agencies to concur between themselves what single value the State would use for both purposes.

two sparse paragraphs of its order (R. 9, ¶¶ 8-9), which do not provide even the most rudimentary roadmap to its analysis of the facts and circumstances before it.

2. How is the Commission's ultimate reliance on the income method and the conclusion that the stock-and-debt method is an independent "test" of the cost method reconciled with Prof. Hal Heaton's uncontested evidence that, except for minor differences, the "income" method is no more than the stock-and-debt method in disguise?[4] (R. 65, 262, Questar O.B. at 25-29.)

3. How did the Commission reconcile the fundamentally different approaches of the Division's witnesses to FMV? What witness, what evidence and what theories from the Property Tax Division's diversity of witnesses did the Commission rely on? For example, Prof. Hanke and Mr. Prawitt had a major philosophic disagreement about the applicability of the stock-and-debt method. (R. 201-02.) Another example: Did the Commission rely on Prof. Hanke's and Mr. Goodwin's totally irrelevant examples of the California houses that might have a market value completely different from their replacement or cost values? (Tr. 126, 205-06.) Since the hypothetical houses were not subject to original-cost ratemaking constraints, the Commission could hardly rely on this "evidence" as the basis for rejecting the position that the rate base for a FERC-regulated company and its FMV are closely related. Did it?

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[4]For example, Prof. Hanke, who espoused total reliance on the stock-and-debt method, could not take issue with Prof. Heaton's demonstration. (R. 150.)

4. Did the Tax Commission rely on the testimony of Mr. Prawitt? How did it square his tenacious and implacable insistence on a $300 million evaluation with his disregard for the spirit and letter of the settlement framework? Mr. Prawitt's cross-examination testimony, for example, illustrates that he never did grasp the significance of the stipulation and that he did not consider the agreed-to values in the context of the stipulation.[5] (*See also* discussion in § IV below.)

5. In what sense was the cost method the "least reliable" when there was no dispute over the formulaic determination of this method under FERC rate

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[5]The following colloquy is particularly revealing (R. 161-62):

> Q . . . Now, our [Questar's] case was that we were given the three numbers, and we agreed with the Property Tax Division three numbers, 210, 303, and 312, to form the basis of some sort of a composite result. We engaged an expert witness to make an analysis of that process with those numbers and [he] came up with a relatively narrow range. Now, we presume[d] that the Property Tax Division would do exactly the same thing . [. . . To] take those three numbers as given numbers and through some procedure that is describable and can be looked at, would find a correlated value that's consistent with the Property Tax Division's approach to correlation generally. Did you do that?
>
> A Did I do what? I think I missed the question.
>
> Q Did you take these three numbers and forget about where they come from and decide what was the relative reliability from your point of view and derive a correlated value, a weighted value?
>
> A If you're talking about the $292 million value?
>
> Q No, I'm talking about Column D [of Exhibit 1.]
>
> A Did I, or can I?
>
> Q Did you?
>
> A No, I have not . . . .

regulation? Indeed, it is the least subjective of the methods because of its regulatory origin. (R. 75-76, 102.)

The Commission's answer to its failure to address these and other subordinate factual issues and to provide a logical chain of reasoning is its theory that the Court should defer to its conclusory "judgment" of the ultimate factual issue and that "[v]aluation is an art, not a science." (Commission Brief at 41.) Merely characterizing its tax-assessment obligations as an "art" does not allow the Commission to escape accountability for the results it imposes. A two-paragraph statement of conclusions does not measure up to requirements of *Milne*, *Mountain States* and Utah Code Ann. § 63-46b-16(4)(g) and (h) (1989).

C. There Is No Rational Explanation of the Choice of a FMV of $296 Million.

In its Brief (page 43), the Commission argues that the record supports the finding of a $296 million FMV because it is "squarely within the range of value proffered by the Property Tax Division" and that "it should be enough to simply choose a value with[in] the range of values presented to the Commission." No legal authority is cited for this claim to an extraordinarily broad license.

First, to "simply choose a value" does not allow the taxpayer and the Court to evaluate whether there are rational chains of logic and reasoning and findings of subordinate facts to determine if the Commission has been arbitrary and capricious. *Milne*, 720 P.2d at 1378. The Commission's claim that a value picked out of a range of values discussed by witnesses at the hearing satisfies the UAPA's substantial-evidence test seriously misconstrues the standard. Because the ultimate finding of fact (FMV = $296 million) requires the determination of a series of subordinate facts that the Commission never addressed, the Commission's action cannot be sustained.[6]

Second, the Property Tax Division didn't "proffer" any range. The only Division witness who discussed actual values was Mr. Prawitt, who stated directly, squarely in the face of changes in the methods' values over the course of the proceedings, that $300 million continued to be the correct correlation of the values. (R. 171-97.) Only on some follow-up questioning from Commissioner Davis did he allow that "the value *could* be between $290 and $310, or $320"—hardly a "proffer." (R. 188 [emphasis added].)

Still, the Commission apparently has relied on Mr. Prawitt's testimony—since no other witness except Prof. Heaton made any concrete recommendation. In so doing, it has relied on a witness whose key testimony on the correlation issue exhibited a disregard for or misunderstanding of the role of the stipulated facts and a logically inconsistent approach to the analysis that could not be relied upon by a reasonable fact-finder.

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[6]There is nothing in the order to distinguish the Commission's claimed exercise of judgment from simply accepting, without question, its staff's recommendation. *See, e.g., Mountain Fuel Supply Co. v. PSC,* 662 P.2d 878, 887-88 (Wyo. 1983) (court couldn't discern whether PSC had automatically, uniformly, and unlawfully adopted its staff's recommendations on the utilities' rates of return, independent of the evidence).

The point is not that the Commission must pick one number that was testified to by a specific witness, but that it must exercise its responsibility to assess the record as a whole and arrive at subordinate and ultimate conclusions by rational and discernable means, applying the law to all the evidence before it. This, Questar believes, the Commission has not done.

The fundamental problem with the Commission's claim of license to engage in judgment and art is that it camouflages arbitrary and capricious actions. The essence of the Commission's arguments on pages 36-43 of its Brief is that it has essentially free rein to choose nearly any value for the FMV so long as one of its staff or their retained witnesses testifies to a range that includes the final number. *No* reasonable administrative review standard should allow this liberty, much less the more stringent review standards adopted by the Utah Legislature—the UAPA.

D. Standard of Review

Although Questar believes that the Commission action is sufficiently defective that it would not have passed the tests of lawfulness under the pre-UAPA statutory framework, the UAPA—with its wider grant to the Court to consider evidence "when viewed in light of the whole record"—provides the standard of review for this case, which was initiated after January 1, 1988.

The Commission Brief (page 46), on the other hand, urges the Court to apply the standards articulated in *Vali Convalescent and Care Institutions v. Division of Health Care Financing*, 797 P.2d 438 (Utah App. 1990), and a previous case cited in *Vali*, *USX Corp. v. Industrial Comm'n*, 781 P.2d 883 (Utah App. 1989). *Both cases are pre-UAPA cases*, and the standards articulated and discussed there are not directly applicable to the case before the Court. Judge Orme points this out in *Vali* by noting that "somewhat less deference is accorded in connection with the review of an agency's factual determinations when the Administrative Procedures Act is applicable." 797 P.2d at 443 n.6.

Even weaker is the Commission's urging on the same page of its brief that the Court adopt the review standards discussed by the Washington intermediate appeals court in cases that did not involve statutory provisions that are equivalent to the UAPA.

II. When the Evidence Is Marshalled, the Commission's $296 Million Evaluation Does Not Pass the Applicable UAPA Tests

As the Commission Brief correctly points out (page 10), this Court and the Court of Appeals have required parties who believe that agency decisions are not supported by substantial evidence when the record is viewed as a whole to "marshall the evidence" to make such a showing. *First National Bank of Boston v. County Board of Equalization*, 799 P.2d 1163, 1165 (Utah 1990); *Grace Drilling Co. v. Board of Review*, 776 P.2d 63, 68 (Utah App. 1989). But, no matter how much evidence is marshalled in this proceeding, the words of the *Bank of Boston* opinion apply here: "Nothing in the record indicates how the Tax Commission arrived at the figures" that the Commission chose as the FMV of Questar's system.

Further, Questar does not believe that the *Bank of Boston* case stands for the proposition that the raw quantity of evidence automatically satisfies the substantial-evidence test. If that were the case, there would be no place for considerations of quality of the evidence. To put it another way, the Commission's theory of substantial evidence would not take account of questions of logical consistency, the reasonableness of the conclusions and the applicability of the law, as required implicitly by the UAPA and explicitly by cases such as *Milne*, *Mountain States* and *Hurley v. Board of Review*, 767 P.2d 524, 527 (Utah 1988) (questions of mixed fact and law subject to a "reasonableness standard").[7]

As discussed in more detail in Questar's Opening Brief, (1) it is not clear what evidence the Commission's December 3, 1990, decision relied on, and (2) any rational evaluation of the evidence, when the record is considered as a whole, would not pass a reasonableness test. The latter observation obtains if for no other reason than the result does not account for the enormous disparity between the Commission's $296 million evaluation and the $210 million investment base on which the Company's revenue and income streams are determined on a just-and-reasonable basis by the FERC.

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[7]*Hurley* is a pre-UAPA case, but the mixed-law-and-fact standard is still applicable in the UAPA framework. *Pro-Benefit Staffing, Inc. v. Board of Review*, 775 P.2d 439, 441-42 (Utah App. 1989).

III. THE COMMISSION BRIEF'S DISCUSSION OF THE COST METHOD FURTHER CONFIRMS THE UNLAWFULNESS OF ITS APPARENT REJECTION OF ITS USE

The substantive argument in the Commission Brief commences with what purports to be a discussion of the cost method, but immediately proceeds totally to mischaracterize the cost method used in the proceeding as the *replacement* cost: "what it would cost for a willing buyer to *reconstruct* the subject property." Commission Brief at 13 (emphasis added). How can the taxpayer or this Court feel that the taxpayer has been subjected to a fair, impartial and knowledgeable evaluation of the evidence when one of the premier issues—the role of the **depreciated original cost** (rate base) evaluation, the "cost method"—is treated with such carelessness in the Commission's Brief? If the Commission gave no more consideration to the merit of the cost-method arguments than is indicated by the treatment in its brief, then its claims that it "properly considered all evidence and gave all due thought and consideration to Questar's arguments and experts' opinions"[8] ring hollow indeed.

If the issue *had* been whether the Commission should place primary weight on the value of *reconstruction costs*, then the Commission's rejection of the cost method would be justifiable; Questar would agree that there is relatively little nexus between that value and FMV for an original-cost rate-base-regulated inter-

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[8]Commission Brief at 45.

state pipeline.

But, of course, that was never the issue. Replacement or reconstruction cost was *never* discussed in the proceedings. To the extent the Commission's Brief represents its understanding of the issue and rejection of the rate-base /cost method as unreliable, the Commission has made an error of the first magnitude. If not, it does not speak well of the Commission's care in treating the issues that have brought the parties before the Court.

Apparently in support of this erroneous definition of the cost method used in the case, the Commission's Brief (page 13) then cited a case that squarely supports Questar's position that FMV appraisals of rate-regulated companies must focus on the fact that companies whose rates and income streams are strictly constrained to produce a return on utility-type rate base. *Pacific Power & Light Co. v. Dept. of Revenue*, 308 Or. 49, 775 P.2d 303 (1989), found that the rate-base/cost method was a reasonable measure of FMV. The Oregon Supreme Court's qualitative analysis (in a *de novo* review) is particularly instructive, because it was faced with a central-assessment case similar to the one before this Court. Contrary to the Utah Tax Commission's summary dismissal of the rate-base/cost method as the "least reliable" of the three methods, the Oregon court looked at the clear connection between the HCLD[9]—*i.e.*, the rate base—and

[9]HCLD: Historic cost less depreciation—the "cost approach," derived from the utility's annual report to the Federal Energy Regulatory Commission. *Id.* at

FMV to conclude:

> Accepting that . . . what we are searching for is what a hypothetical willing buyer of this property would pay to a hypothetical willing seller, it seems clear to us that a willing buyer of the plant and equipment would be agreeable to paying a figure close to HCLD, because the buyer could then earn off all that expenditure.

A weight of 45% was assigned to the cost method in the Oregon case.[10] It is significant that specific weights *were* assigned so that the actual "correlated" value could be determined from the three individual components. *Id.* at 312.

This is contrary to the Utah Tax Commission's approach of refusing to state weighting factors for the methods, depending on its judgment to divine a proper FMV. According to the Commission, "no 'weighting' formula is required," notwithstanding that it never addressed the issue of "the moving target." Commission Brief at 45. Compare discussion in Questar O. B. at 33-40. *See also*, *e.g.*, Wyo. Tax Comm'n Rules and Regs., ch. XXII, § 14(c): "Any taxpayer . . . , upon request, will be provided with . . . [t]he relative weight assigned to each of the methods if more than one is used and an explanation of the weighting used."

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307. This is the same rate base used in the Questar case.

[10]Although the specific choice of 45% is not particularly significant here because no party contested the percentages, the court's analysis confirmed that a substantial weight should be given to this rate-case evaluation method. If the issue had been contested, it is hard to speculate whether the Oregon Supreme Court would have attached a weight higher than 45% on the basis of its finding that investors are obviously limited by the rate base (HCLD).

It is also notable that the Oregon court's qualitative analysis of the cost method for an FERC-regulated company went on to observe that there was record evidence "to the effect that regulation to some extent diminishes the earning potential of regulated property and, therefore, a willing buyer would wish to discount the property to some degree." *Id.* This, of course, was dictum in the *Pacific Power* decision, but it illustrates the intuitive understanding of the constraints placed on an investor/buyer and further illustrates that the Utah Commission's summary disposal of the cost method is an abuse of its discretion.

Finally, as a minor but indicative point, the Commission Brief—presumably in rationalizing its minimal use of the cost method—states that Questar's FMV is "more accurately measured by the income method and the stock and debt method *since both of these methods are market based.*" Commission Brief at 4 (emphasis added). This is simply not correct. The income method is *not* market-based, and no witness so testified.[11] This is another example of Commission carelessness with the evidence.

IV. ARGUMENTS PUT FORTH IN THE COMMISSION BRIEF EVIDENCE A MISUNDERSTANDING OR MISUSE OF THE STIPULATION

In an attempt to simplify the case and focus on an issue on which Questar and the Property Tax had material disagreement, the parties stipulated (1) that the

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[11]The Division's own witness was emphatic about this: "So it is not a market based method of evaluation . . . ." (R. 125.)

overall FMV evaluation should be derived form the values obtained from the three "standard" evaluation methods (cost, stock-and-debt, and income) and (2) the values of the three methods and the accuracy of their derivations would not be at issue. (R. 380-81.)[12] Thus, the framework agreed to by the parties was a substitute for the presentation of full, comprehensive appraisals[13] by the parties. Accordingly, *no witness sponsored a full appraisal*, because the purpose of the evidentiary proceeding was limited to the determination of a proper combination of the three values, *i.e.*, the "correlation" of the stipulated values, to obtain Questar's FMV. The proceeding was thus abbreviated to issues involving the reliability and propriety of the various methods in determining FMV.

The Commission's Brief indicates a material misunderstanding or misuse of the stipulated facts and issues. For example, the brief (pages 37-38) criticizes Questar witness Prof. Heaton because he did not conduct a complete appraisal. But the stipulation obviated a complete appraisal, requiring *all* witnesses to start at a point far down the road from conducting a complete appraisal. Again, that was the point of the stipulation, and its operational effect was to provide a common starting point for each party and witness—one that did not involve a comprehen-

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[12]A copy of the Stipulation of Facts and Issues is attached as Addendum A to this Reply Brief.

[13]"Appraisal," as used in the Commission Brief, apparently refers to a complete assembly of company data and information, the derivation of all the components and application of appropriate methods of estimating FMV, and correlation or weighting of the results of the separate methods.

sive appraisal. *No one* conducted a complete appraisal that was part of the post-stipulation proceedings and record. Certainly, Division witnesses Goodwin and Hanke did not conduct any appraisal. Their testimony was almost entirely theoretical or advisory in nature, limited generally to commenting on the theory of the methods at issue. Nor did Mr. Prawitt sponsor an appraisal (even though he may have at one time performed one that produced different individual results than those stipulated to.)

It is fundamentally inconsistent with the established facts in the case, *i.e.*, the stipulation, to reject or minimize the import of Prof. Heaton's evidence on the basis of his not having performed a complete appraisal. An arm of the Commission (the Division) entered into a stipulation of issues that explicitly eliminated a portion of the potential issues. On brief, the Commission then explains that it rejected or accorded less weight to Prof. Heaton's evidence *because he did not address issues that were stipulated to.* This is grossly unfair to the witness and to the taxpayer. It is notable that the Commission (apparently) did not correspondingly discount the evidence of Prof. Hanke and Mr. Goodwin; yet, they too conducted no appraisal. The Commission's logic on this point is not supportable.

Prof. Heaton, as did Division witnesses, addressed the relative merits of the three component methods. His testimony and exhibits were, as the framework of the stipulation called for, based on an analytic method for determining the most reliable (*i.e.*, the best) estimator of FMV. Although there may be other legitimate methods for addressing the problem, it is an abuse of agency discretion to discount or reject a witness's evidence on the basis of its mischaracterization of the process and of the witness's testimony.

The Commission's summary dismissal of the only comprehensive, analytic attempt to solve the problem defined by the stipulation relies on a mischaracterization of key evidence and its view that property tax determinations are an "art, not a science." This is arbitrary and capricious and not in compliance with the requirements of *Milne* and *Mountain States*.

On a similar point, it is contrary to the framework of the stipulation for the Commission to claim (page 25) that Questar agreed that the value of its property is as much as $300 million simply because those are the stipulated values of two of the methods. The parties did not concede the relative merits of the stipulated values. That was the entire point of the controversy. "[T]he parties do not . . . agree on the relative merits of the individual approaches." (R. 380, ¶ 1(b).) Thus, the Commission's logic, when applied to the Property Tax Division, would imply they agree that the value of the Company is as low as $210 million.

V. THE COMMISSION'S BRIEF DOES NOT JUSTIFY DIFFERENT TREATMENT OF THE STOCK-AND-DEBT METHOD FOR QUESTAR, VIS-À-VIS NORTHWEST PIPELINE

At pages 19-25, the Commission Brief tries to justify why it has accorded materially different treatment of the stock-and-debt method to Northwest Pipeline Corporation (Northwest) and Questar.

The evidence in this case concerning the stock-and-debt method establishes beyond reasonable argument that a *direct* evaluation of Questar, as a second-level, minority subsidiary of a diversified parent, through the aggregate value of its common stock and debt is impossible. It is further established that *any* attempt to assign a value to Questar by the stock-and-debt method will require an allocation of some percentage of the parent to the subsidiary or the attribution of characteristics of other "comparable" companies to Questar. (*See* discussion and citations in Questar O.B. at 25-29.)

The conclusion is inescapable that, on the *facts in this record* (and not for the hypothetical publicly traded company for which the stock-and-debt method may be effective), the stock-and-debt method is not a reliable indicator of FMV. It is not reliable because it is indirect and produces a wide range of potential values, as a function of the particular allocation factors or indices that are used. (R. 260-61.)

Thus, the Commission's material reliance on the method as a "test" of another method is not based on the quality of evidence that would persuade a reasonable person who understood the rate-regulatory limitations placed on the earning value of Questar. On the merits under the facts of this case, the Commission's substantial reliance on the stock-and-debt method in the face of the fundamental role played by its FERC rate base in determining the earning power of Questar is not supported by substantial evidence when the record as a whole is considered.

Further, the Commission's somewhat inscrutable treatment of the Northwest Pipeline Corporation case, as discussed in the Questar Opening Brief (pages 27-29) and its Supplement to the Opening Brief, detracts further from any justifiable reliance on the stock-and-debt method. There is no dispute that the Commission was mistaken when it claimed that the common stock of Northwest's parent, The Williams Companies, was not publicly traded. (Commission Brief at 25.) But the Commission attempts to rationalize away its inexplicable error by arguing, in effect: So what if we didn't have the facts straight, the reasoning was OK.

There are two major problems with the explanation in the Commission Brief. (1) How could the Commission not be aware of a factual matter that it claims is so vital to the analysis of the applicability of the stock-and-debt method to a major centrally assessed company?[14] A partial answer is that the erroneous "the parent is not publicly traded" argument appears to be an afterthought to the Commission's rejection of the stock-and-debt method, not the primary evaluation. As pointed out in Questar's Initial Brief, the thrust of the analysis was that the allocations necessary to evaluate a company two subsidiary levels down rendered the method unreliable. The secondary (but incorrect) observation was given as further confirmation. Why else would the Commission begin this secondary point

[14]This may also raise a question concerning the level of deference to be accorded to an agency's expertise.

with "*Further*, there is no specific information available . . . ."?[15]

(2) More fundamentally, the Commission's treatment of Questar produces the irreconcilable inequity that two extensive interstate pipelines with major operations and property in Utah and otherwise similarly situated are subjected to substantially different taxation treatment. This does not measure up to the standards of UAPA § 63-46b-16(4)(h)(i) and (iii). The Commission's basis for the inconsistency is not "fair and rational."

CONCLUSION

For the reasons set forth in this Reply Brief, Questar believes that the Commission Brief has not established the lawfulness of the December 3, 1990, order, and seeks an order of the Court providing the relief sought in Questar's Opening Brief.

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[15]The full context from the Commission's order was:

> The parent corporation raises capital by the issuance of its own debt and that capital is then utilized in the business operations of the Williams Company [*sic*] and its several subsidiaries, including Petitioner. Therefore, it is very difficult to determine what portion of the stock and debt of the Williams Company should be allocated to Petitioner. Further, there is no specific information available concerning the market value of the non public stock.

Questar O.B., Addendum C, at 6.

Respectfully submitted,

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Counsel for
Questar Pipeline Company,
a Questar Corporation subsidiary

July 22, 1991

R88-080\PROP88.BFR

ADDENDUM A

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APPEALS SECTION
STATE TAX COMMISSION

BEFORE THE STATE TAX COMMISSION OF UTAH

QUESTAR PIPELINE COMPANY, Petitioner, v. PROPERTY TAX DIVISION OF THE STATE TAX COMMISSION OF UTAH, Respondent.	STIPULATION OF FACTS AND ISSUES Appeal No. 88-1456

In the spirit of narrowing the issues that have been raised in this proceeding, Questar Pipeline Company and the Property Tax Division of the State Tax Commission of Utah (the Division) stipulate to the following facts and issues for purposes of the hearing in this proceeding:

1. (a) The parties stipulate that the three approaches to the total assessment of the Company's taxable property shall be those generally referred to as the cost method, the income method and the market (or stock-and-debt) method. The parties further agree that these three approaches yield the following estimates of Questar Pipeline's total system value for the taxable year 1988:

Cost Method	$210,492,693
Income Method	$303,000,000
Stock-and-Debt Method	$312,321,375

(b) Having stipulated to the amounts in § 1(a), the parties do not necessarily agree on the methods, assumptions or variables that were used to derive such values, nor do they agree on the relative merits of the individual approaches, nor does this stipulation in any way limit, estop or otherwise serve to diminish either party's rights to present and pursue such positions, methods, approaches and arguments as it sees fit in any other proceeding.

(c) In consideration of stipulating to a market indicator different from that stated in the Division's April 29, 1988, Notice of Assessment, the parties further agree that neither party will advance any argument in this proceeding concerning correlation of market-value indicators that emphasizes or relies on the relative difference between the income and stock-and-debt methods to imply or conclude that the cost method is inferior or superior or should be entitled to a smaller or greater consideration or weight. This provision does not in any way limit the right of either party to advance arguments concerning the strength or weakness of the cost method on any other grounds or theory.

2. The parties agree that (a) the Utah allocation of Questar Pipeline's correlated system market value shall be 48.04%, and (b) Questar Pipeline's Utah property that is not subject to assessment shall be determined by the same method reflected in the Division's April 29, 1988, Notice of Assessment (worksheet summary), subject to the final determination of the correlated market value of total utility property in this proceeding.

3. The sole issue to be litigated in this proceeding is the "correlation" of the three values stipulated to in § 1 above, from which a single total-company assessed valuation is to be determined. Each party may advance and pursue such evidence and argument as it deems appropriate (subject to § 1(c)) in establishing the method by which the three stipulated values should be used to determine a single "correlated" value.

This stipulation is entered into this 29th day of September 1989.

Respectfully submitted,

PROPERTY TAX DIVISION,
STATE TAX COMMISSION OF UTAH

Leon A. Dever
Assistant Attorney General
State of Utah

QUESTAR PIPELINE COMPANY

Gary G. Sackett
Attorney for
Questar Pipeline Company

CERTIFICATE OF SERVICE

I, certify that on July 22, 1991, I served four copies of the Reply Brief of Petitioner, Questar Pipeline Company, by first class mail upon counsel for respondent in this matter to the following address:

R. Paul Van Dam, Attorney General
Kelly W. Wright, Assistant Attorney General
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Gary G. Sackett

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